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Subrogation - Assignment or Benefit of Security or Incumbrance - Whether a Subsequent Lender Is Subrogated to Rights of Original Conditional Vendor as against an Intervening Chattel Mortgagee

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require them to go into places of danger which should not be increased by the presence of unlawful quantities of volatile combustibles. Recovery was also granted in the Ryan case where the distinction was made between active negligence and negligence resulting from the actual condition of the premises. As previously noted, it was in this case that the court criticized the traditional licensee-invitee formula. Therefore, it is not surprising that in the instant case the Illinois Supreme Court relied to some extent upon the Ryan and Bandosz decisions in abandoning the licensee-invitee formula and in extending the protection of ordinances, being in general terms, to firemen and policemen.

The factual situation in the present case enabled the Illinois Supreme Court to place great reliance upon the New York rule requiring landowners and occupiers to keep that portion of the premises normally used as a means of access in a safe condition for all persons lawfully entering thereon. The Illinois Supreme Court stated that: ". . . we would agree with the court in the Meiers case, and with its adherents, that an action should lie against a landowner for failure to exercise reasonable care in the maintenance of his property resulting in the injury or death of a fireman rightfully on the premises, fighting the fire *at a place where he might reasonably be expected to be.*"[52] Query, can a fireman or policeman reasonably be expected to be at a place that is not customarily used as a means of egress and ingress? The language of the Illinois Supreme Court could have been limited to the precise factual situation presented, but it would seem that the language used might have left the door open for a liberalization in the future of the limited New York rule. It seems ironic that the court which promulgated the strict majority rule should render a decision which might possibly be used in the future to further a trend aimed at avoiding the harshness of its original pronouncement.

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SUBROGATION—ASSIGNMENT OR BENEFIT OF SECURITY OR INCUMBRANCE —WHETHER A SUBSEQUENT LENDER IS SUBROGATED TO RIGHTS OF ORIGINAL CONDITIONAL VENDOR AS AGAINST AN INTERVENING CHATTEL MORTGAGEE— In the recent case of *Western United Dairy Company* v. *Continental Mortgage Company*[1] a reviewing court of Illinois was presented for the first time with the question of whether the doctrine of conventional subrogation was applicable to a series of transactions involving personal property rather than realty. The plaintiff therein obtained and recorded a

[52] 20 Ill. (2d) 406 at 416-417, 170 N. E. (2d) 881 at 886. Italics added. For a treatment of the present case, see 49 Ill. B. J. 594.

[1] 28 Ill. App. 2d 132, 170 N. E. 2d 650 (1960).

chattel mortgage covering two new refrigerators and other store equipment to secure a loan to the proprietor of a supermarket. The borrower had just purchased the refrigerators on a conditional sales contract. Some two weeks later the supermarket operator again needed funds and sought the aid of the defendant finance company. By agreement the latter advanced funds in cash and also paid the remaining balance of the purchase price of the refrigerators, discharging the seller's lien. The defendant and the borrower then entered into a new conditional sales contract covering the refrigerators. The supermarket business did not prosper and the defendant obtained possession of the refrigerators in a replevin action. The plaintiff took action as well, foreclosing the mortgage and purchasing the refrigerators at the chattel mortgage sale. The plaintiff mortgagee then brought this action claiming title to the equipment and the defendant refused possession by virtue of its conditional sales contract. The trial court gave judgment for the plaintiff and awarded damages. The defendant appealed to the Appellate Court, First District, First Division, which affirmed the judgment below, rejecting the defendant's argument that it was subrogated to the rights of the original conditional vendor.

The doctrine of conventional subrogation is discussed in detail in the leading case of *Martin* v. *Hickenlooper*,[2] and is summarized as follows: "In the case of *conventional* subrogation, equity says: Where the lender of money did it with the intention and understanding that he was to be placed in the position of the creditor whose debt he paid, but without taking an assignment of the credit, equity, where no innocent parties will suffer or no right has intervened, will treat the matter as if an assignment had been executed."[3]

In the present case, the appellant, Continental Mortgage Company, argued that it should be subrogated to the original conditional vendor to the extent of the balance due on the contract at the time that it (Continental) paid this balance. The Appellate Court, while recognizing that the doctrine of conventional subrogation has long been applied to real estate transactions in Illinois,[4] declined to apply it to this situation. In reaching its decision, the Court commented that the holding was not based solely on the distinction between land and chattels, but also on the traditional attitude of Illinois courts toward conditional sales liens, which have long been held in disfavor as secret liens.[5]

[2] 90 Utah 150, 59 P. 2d 1139 (1936).

[3] 90 Utah at 157, 59 P. 2d at 1142.

[4] Home Savings Bank v. Bierstadt, 168 Ill. 618, 48 N. E. 161 (1897); Kankakee Federal Savings & Loan Ass'n v. Arnove, 318 Ill. App. 261, 43 N. E. 2d 874 (1943); 34 I. L. P., Subrogation, § 10.

[5] Sherer-Gillette Co. v. Long, 318 Ill. 432, 149 N. E. 225 (1925).

It is interesting to note that very few jurisdictions have passed on the applicability of the doctrine of conventional subrogation to transactions involving chattels, although there are numerous decisions applying the doctrine to dealings with respect to real estate.[6] Extensive research on the problem has disclosed only five cases, which are briefly reviewed here for comparison with the Illinois case. One of these, *Potter* v. *United States*,[7] was decided in Rhode Island in 1953 and was a declaratory judgment action. The facts were that a restaurant operator purchased equipment for his establishment and gave a chattel mortgage covering the various items to secure a note. The mortgage was properly recorded. Some two years later the federal government recorded a lien on the equipment for social security and withholding taxes. Soon thereafter the restaurant operator approached one Potter, the plaintiff in that action, and succeeded in obtaining a new loan from him, the proceeds of which were used to retire the old note, the remaining balance of which was greater in amount than the federal taxes owing. Nothing was said about the government tax lien and Potter did not search the records. No assignment of the old chattel mortgage was taken. However, the new chattel mortgage did contain a warranty that the property was free of incumbrances. The new mortgage was properly recorded and several months later Potter began foreclosure proceedings as nothing had been paid on the new note. On the same day the government seized the property and shortly thereafter Potter instituted his action for a declaratory judgment as to the superiority of his claim.

The District Court held that Potter was subrogated to the original chattel mortgagee for the amount of the indebtedness which existed at the time that the old note was retired. The Court cited as authority a federal case, *Burgoon* v. *Lavezzo*,[8] and a state case, *Industrial Trust Company* v. *Hanley*,[9] both of which dealt with land rather than chattels. In the course of the opinion the Court stated: "Another reason advanced by the Government for disallowing subrogation in this case is that the property involved here is personal property rather than real estate. But no case has been cited in support of making such a distinction, and the Court is not aware of any reason sufficient to warrant a distinction being made on this ground. . . . If justice will be served by allowing subrogation, conceptual and formalistic arguments will not bar the granting of relief."[10]

[6] See the cases concerning real estate transactions collected in annotation in 70 A. L. R. 1396.

[7] 111 F. Supp. 585 (D. R. I., 1953).

[8] 92 F. 2d 726 (CADC, 1937).

[9] 53 R. I. 180, 165 A. 223 (1933).

[10] Supra, n. 7 at p. 588.

A second federal case involving chattels, *United States* v. *Halton Tractor Company, Inc.*,[11] arose in California, and the factual situation was similar to that in the case just discussed. One Watson purchased heavy equipment used in the construction of roads and financed the purchase in part with a Morris plan mortgage. Some six months later, the federal government filed its lien for social security and withholding taxes due from Watson. Subsequently, Watson approached the plaintiff, Halton Tractor Company, Inc., and obtained new financing for his equipment. As in the preceding case there was no assignment of the old mortgage, the new mortgagee was unaware of the tax lien, the mortgage contained a warranty that there were no other incumbrances, and both the new and the old mortgages were properly recorded.

Halton Tractor paid the tax lien to prevent seizure of the road equipment which it had acquired upon Watson's default, and then filed a claim for a refund of the tax. Upon denial of the claim, Halton sued in the United States District Court, Northern District of California, where the case was consolidated with another arising out of similar dealings with Watson. The District Court agreed with Halton's contention that it was subrogated to the prior rights of the original mortgagee and the Court of Appeals affirmed. Both *Burgoon* v. *Lavezzo*[12] and *Potter* v. *United States*[13] were cited, and comment was made that the California law with respect to subrogation was as liberal as that expressed in federal decisions.

Two state cases involving chattels are cited in *Corpus Juris Secundum*, and the statement is made that "a purchaser of a chattel who discharges the lien of a conditional seller has been held entitled to subrogation."[14] The first was a New York case, *Meisel Tire Co., Inc.* v. *Ralph*,[15] involving an automobile which one Weaver had purchased on a conditional sales contract and subsequently mortgaged. Both the contract and the mortgage were recorded. Subsequently Weaver sold the car to the defendant who, unaware of the mortgage, paid the original conditional vendor and resold the car. In an action in the nature of conversion on an agreed statement of facts, the New York court dismissed for want of complete information in the agreed statement. One of the fact deficiencies was the amount paid by the defendant to the original vendor to discharge the conditional sales contract, merely given as "above $50." In dismissing, the court stated, however, that the defendant would be subrogated to the conditional vendor in the amount which he paid to the latter. Worthy of mention is the

11 258 F. 2d 612 (9th Cir., 1958).
12 Supra, n. 8.
13 Supra, n. 7.
14 83 C. J. S., Subrogation, § 33.
15 164 Misc. 845, 1 N. Y. S. 2d 143 (1937).

court's criticism of the New York rule permitting imprisonment for an unsatisfied judgment in conversion.

The other case cited in *Corpus Juris Secundum* was *Pacific States Savings and Loan Co.* v. *Strobeck.*[16] A large purchase of furniture for an apartment building was made on a conditional sales contract. The furniture was later subjected to the lien of a mortgage made when the building was sold. The building changed hands several times in the early years of the depression and the chattel mortgage on the furniture was foreclosed. However, the transferee of the conditional vendee was held subrogated to the conditional vendor as to the amount of the final payment made on the conditional sales contract. Amounts paid on the contract prior to the final payment by the same transferee were not included in the sum for which subrogation was allowed. In this case, the transferee had taken an assignment of the vendor's rights under the contract.

Turning to a case in which subrogation was denied, *Citizens State Bank of Tulsa* v. *Pittsburgh County Broadcasting Co. et al.,*[17] the facts were that one McDonald purchased a Nash automobile and obtained a loan secured by a chattel mortgage from a bank in McAlester, Oklahoma. Subsequently, he obtained loans secured by chattel mortgages from three other sources, one of which was in Arkansas. In each case the chattel mortgage was filed for record in the county where the loan was made. Upon moving to Tulsa, McDonald asked the defendant bank to pay off the McAlester bank's loan so that payments would be more convenient. The defendant bank did so and recorded the fifth chattel mortgage on the car. No assignment was taken from the first bank but the papers were cancelled and forwarded to the defendant bank upon receipt of the check. Subsequently the defendant bank acquired the car and sold it, the proceeds being impounded subject to the decision of the court. The trial court held that the defendant bank was not subrogated to the first bank, and the Supreme Court of Oklahoma affirmed. In the opinion it was stated that the defendant did not prove an "express or implied agreement or understanding that it was to have the benefit of the security held by the McAlester Bank."[18]

With this brief background of cases from other jurisdictions, let us look more closely at the reasons of the Illinois Appellate Court for denying subrogation to Continental Mortgage Company. The Court stated: "We do not base our decision solely on the distinction that our case involves

[16] 139 Cal. App. 427, 33 P. 2d 1063 (1934).

[17] 271 P. 2d 725 (Okla., 1954).

[18] Id., at p. 727.

chattels rather than land, but rather on the pronounced difference in the attitude of our courts when dealing with conditional sales liens rather than other forms of security. Prior to our adoption of the Uniform Sales Act . . . our courts gave no effect to these liens against innocent third parties. . . . Although the Sales Act changed this, the legislature has not required that these liens be recorded. Due to the adverse effect these secret liens have on open dealings in chattels, our courts have consequently strictly limited their use to actual vendor-vendee situations and have refused to give them effect when they are used as mere financing arrangements."[19]

The Court's position appears to be that "conventional" subrogation to a conditional vendor is an impossibility in Illinois under any circumstances. A conditional sales lien is to be accorded priority over other liens only where a *bona fide* vendor-vendee relationship exists. As soon as the vendor is paid and the contract cancelled, that relationship ceases. Anyone else claiming to stand in the vendor's shoes is defeated from the start as his appearance on the scene is not in the role of a seller of goods or as an assignee of a seller of goods, but merely as one who finances the purchaser.

An additional reason given by the Court for denying subrogation was that chattels, unlike land, depreciate in value and this may affect the position of those who have intervening liens. The quicker that the financial troubles of the borrower are brought to a head, the greater the protection for all who have liens, as there has been less depreciation in value of the property and more will be realized on a sale.

It must be said that the Illinois Court has advanced two reasons for denying conventional subrogation which have not received attention in other cases. However, the Court went on to comment on the lack of diligence of Continental in searching the record. Perhaps this was the underlying reason for the decision. As the Court said, this was not a situation involving untrained persons, but one where experienced commercial dealers were engaged in the ordinary course of their business. The Court did not feel that the hand of equity should be extended to help the defendant, who could so easily have avoided involvement by searching the record, or protected his position by taking an assignment.

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[19] 28 Ill. App. 2d 132, 135, 170 N. E. 2d 650, 651 (1960).